6

NO. 84-165

IN THE

SUPREME COURT OF THE UNITED STATES

FEBRUARY TERM, 1985

W. GEORGE GOULD, PETITIONER

v.

MAX A. RUEFENACHT, et al.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT, CHRISTOPHER J. O'HALLORAN

ROBERT J. KELLY, ESQ.
Tompkins, McGuire & Wachenfeld
Attorneys for Respondent,
CHRISTOPHER J. O'HALLORAN
550 Broad Street
Newark, NJ 07102
(201) 622-3000

2

INDEX

TABLE OF CITATIONS

Statutes and Rules

OPINIONS BELOW

The opinion of the Court of Appeals [Pet. App. A, 2a-43a] is reported at 737 F.2d 320 (3d Cir. 1984). The opinion of the District Court (App. at pp. 57a) is not reported.

JURISDICTION

The judgment of the Court of Appeals was entered on June 11, 1984. The petition for a writ of certiorari was filed on July 27, 1984 and was granted on November 13, 1984. The jurisdiction of this court rests upon 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether an individual can successfully maintain a cause of action pursuant to the Securities Act of 1933, 15 U.S.C. §77b(1) and the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10) where the economic reality of the transaction, albeit denominated by the parties as a transfer of "stock," reveals that the purchaser did not expect to derive profit solely from the efforts of others.

STATEMENT

Continental Import & Export, Inc. is a company engaged in importing wines and spirits. Joachim Birkle is the president of Continental and owned or controlled 100% of its stock until 1980. Max A. Ruefenacht, the plaintiff-respondent herein, alleges that early in 1980 he purchased a 50% interest in the company for $250,000 allegedly in reliance on financial documents and oral representations made by certain defendants.

Ruefenacht claims that the defendants violated §12(1) of the Securities Act of 1933, 15 U.S.C. §77(1)(1) (Amended Complaint, App. at 26a-27a), §12(2) of the Securities Act of 1933, 15 U.S.C. §77(1)(2) (Amended Complaint, App. at 27a-32a), §17(a) of the Securities Act of 1933, 15 U.S.C. §77(q)(a) and §10(b) of the Securities Act of 1934, 15 U.S.C. §78(j)(b) and Rule 10b-5 of the Securities and Exchange Commission promulgated thereunder, 17 C.F.R. §240.10b-5 (Amended Complaint, App. at 32a-36a). Additionally, Ruefenacht asserts state common law causes of action against the defendants (Amended Complaint, App. at 36a-44a).

An oral agreement was entered into between Ruefenacht and Birkle whereby Ruefenacht agreed to purchase 50% of what was designated

as the stock of the corporation. The sale was accomplished by Ruefenacht purchasing 2,500 newly issued shares of stock in Continental, representing 50% of the company's issued and outstanding shares of stock (R.2, App. at 225(a)).

Prior to Ruefenacht's purchase of the Continental stock, 49% of the outstanding stock was owned by Birkle, 50% was owned by a German corporation and 1% was owned by Birkle's wife (App. at 25a). After his purchase, Ruefenacht was 50% shareholder in the corporation, Birkle owned 24.5%, the German corporation owned 25% and Birkle's wife owned one-half of 1%. (App. at 24a-25a). Ruefenacht and Birkle agreed that Ruefenacht would purchase the 2,500 shares for $250,000 (App. at 52a). Ruefenacht only paid $120,000 of the agreed upon purchase price.

Ruefenacht was interested in acquiring Continental as a vehicle for importing beer produced by a European brewery owned by his wife's family. (R.2, App. at 52a). Ruefenacht testified that before he purchased the stock he was "checking out" the possibility of importing the beer. (1T: 22-7 to 23). After he told Mr. Ernest Stoecklin about his interest, Stoecklin introduced him to Birkle (1T: 19-13; 1T: 22-17 to 19).

Ruefenacht envisioned himself as a partner in Continental who, together with Birkle, would share the top level decisions of the company. (R.3, App. at 52a) Ruefenacht intended that he would become chairman of the board of directors and he was to receive an annual salary of $24,000.

Ruefenacht recognized that the reduced price he paid for his shares reflected the fact that he was to become actively involved in the management of Continental. (1T:

54-14 to 57-11; 1T: 63-19 to 64-13; Ruefenacht 12/21/81 deposition at T: 88-21 to 89-7, T: 125-3 to 126-9, App. at 280a-284a).

Not only did Ruefenacht intend by his purchase to become an active participant in the business, in fact his activities after the acquisition demonstrate such an active participation. As found by the Magistrate, Ruefenacht's "participation in the affairs of the company during the few months involved bespeaks an intention to actively participate in the company's affairs." (R.4, App. at 53a).

The parameters of Ruefenacht's intended control of Continental are illuminated by the provisions of a shareholders agreement which Ruefenacht and Birkle intended to enter into. (App. at 238a-249a). The agreement provided Ruefenacht with absolute veto power over all major decisions including business acquisition, sale of a major portion of the business, issuance of stock, declaration of dividends, and withdrawal of more than $500 above salary by either Birkle or Ruefenacht. (App. at 239a). While the agreement was never signed, the Magistrate specifically found that Ruefenacht intended to enter into a shareholders agreement substantially in this form (R.2, App. at 52a). Ruefenacht confirmed in his testimony that he and Birkle acted consistent with the terms of the agreement, as both had to agree on top level decisions of the company including issuance of stock, introduction of new product lines and borrowing funds. (R.3, App. at 53a; 1T: 64-12 to 13; 2T: 139-5 to 140-4; 2T: 78-4 to 25).

The status which Ruefenacht achieved by virtue of his acquisition of the stock gave him absolute veto power over all major deci-

sions. He was to become Chairman of the Board of Directors (R.3, App. at 53a) and he was to possess such control over Continental as his position as a director accorded to him (App. at 183a). Ruefenacht was also Continental's vice president and treasurer with the power to sign checks for the company (R.4, App. at 53a). Ruefenacht acknowledged the importance of the banking resolution (App. at 264a) which gave him the authority to direct the utilization of Continental's funds by issuing checks. (2T:121-24 to 122-1).

Ruefenacht was associated with Continental for a relatively short length of time (August through October of 1980). During that time, he participated in thirty meetings on behalf of Continental (R.5--6, App. at 54a-55a). He also spent time during his vacation in Europe on the business of Continental, participating in approximately six meetings with French wine producers (R.5, App. at 54a).

Considering the relatively short length of time Ruefenacht was associated with Continental, it is clear that he devoted a large amount of his own time to the daily affairs of Continental.

Ruefenacht took an active role in Continental's importing business. In the summer of 1980 he met with European wine and spirit producers in Alsace and Southern Germany, bringing with him a letter of introduction and credentials from Continental (R.5, App. at 54a; Ruefenacht 12/21/81 deposition at T:89-12 to 96-25, App. at 270a-278a). Ruefenacht was able to assist Continental's business because he was fluent in several languages including French and he had prior knowledge of the importing business.

After Ruefenacht returned to the United States from his European trip, he took part in numerous meetings where he met with various French wine producers (R.5, App. 54a). Ruefenacht took an active part in the meetings, including approving one particular import contract after he discussed with Birkle how much wine should be ordered. (2T: 107-25 to 108-4).

The trial court concluded that Ruefenacht "intended to exercise joint control of the business with Mr. Birkle; there would be equality of control." (App. at 61a). The record is clear and supports this conclusion.

SUMMARY OF ARGUMENT

In assessing the availability of Federal jurisdiction pursuant to the Securities Act of 1933, 15 U.S.C. §77b(1) and the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10), the pivotal issue of statutory construction facing Federal courts is whether those Acts are intended to apply at all to the myriad of financial transactions which they potentially address. This Court has spoken to this issue on several occasions. In Securities & Exch. Com. v. Howey Co., 328 U.S. 293 (1946), this Court devised an "economic reality" test, whereby a financial transaction would be subject to the control of the Securities Acts only where, inter alia, the purchaser is led to expect that profit will be derived solely from the efforts of a third party. Subsequent decisions of this Court, including United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975), have established that the "economic reality" test is the "guiding principle" applicable to all purported securities transactions, regardless of the characterization of the instrument by which the transaction is effectuated.

Applying this test to the transaction which gives rise to the present Complaint, it is clear that Federal jurisdiction pursuant to the Securities Acts cannot properly be invoked. Although plaintiff herein purportedly purchased shares of "stock" in Continental Import & Export Co., his own testimony and other evidence adduced in the court below unmistakably demonstrated that it was never his intention that profit would be derived solely from the efforts of others. The "economic realities" of this transaction, therefore, should have prohibited the applicability of the Securities Acts.

Certain Courts of Appeal, however, have erroneously bifurcated the test established in Forman depending upon whether the instrument in question is labeled as "stock" or an "investment contract." Further, those courts have interpreted Forman as prohibiting an examination of economic reality where the instruments at issue possess the characteristics associated with ordinary, conventional shares of stock. Similarly, in rejecting the "sale-of-business doctrine," the Third Circuit Court of Appeals in the present matter also expressly refused to apply the economic reality test to a transfer of stock bearing what it regarded as the traditional incidents of stock ownership.

Other Courts of Appeal, on the contrary, have correctly viewed the economic reality test as embodying the essential attributes which run through all of this Court's decisions defining a security. In this view, no particular transaction is exempted from that test. The District Court in the present matter also evaluated the applicability of the Securities Laws on the basis of the Howey/Forman test, and concluded that Federal jurisdiction was lacking since plaintiff herein did not expect that the profits of the enterprise would be derived solely or substantially from the efforts of others. The Court of Appeals erroneously reversed this ruling.

ARGUMENT

APPLICABILITY OF THE FEDERAL SECURITIES LAWS TO THE TRANSACTION AT ISSUE HEREIN MUST BE DETERMINED UNDER THE ECONOMIC REALITY TEST.

The issue before the Court is whether the "economic reality" test articulated by this Court in United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) and other cases applies to this transaction where the economic reality of the transaction, albeit denominated by the parties as a transfer of "stock," reveals that the purchaser did not expect to derive profit solely from the efforts of others. The District Court concluded that the "economic reality" test should be applied and applying that test to the facts herein held that securities law jurisdiction was lacking. The Third Circuit disagreed, rejecting the "economic reality" test in transactions involving purchases and sales of stock. It is O'Halloran's position that the District Court properly applied the economic reality test and correctly concluded that the federal securities laws do not apply to this transaction.

There has been a sharp debate among the Courts of Appeal with respect to the issue of when the "economic reality" test must be applied. There is a sharp split of authority over whether Forman and other Supreme Court precedent mandate that the "economic reality" test apply in all circumstances where the federal securities laws are sought to be invoked, or only to transactions involving "non-traditional" or "unusual" instruments or facially "traditional" instruments lacking "traditional" characteristics.

The "economic reality" test on which the District Court below relied originated

Securities & Exch. Com. v. Howey Co., 328 U.S. 293 (1946). The Court therein considered whether the sale of units of land in a Florida citrus grove by deed, combined with a management contract for cultivating and marketing the produce and remitting the net proceeds to the owner, constituted an "investment contract" under the Securities Act of 1933, 15 U.S.C. §77B(1). Preliminarily, the Court looked to the statutory definition of "security" which, inter alia, included an "investment contract." The Court then considered whether, "... under the circumstances," [id. at 297, emphasis added] the transaction at issue constituted such an investment contract, thereby invoking federal jurisdiction pursuant to, as well as the protection of, the Securities Acts.

At the outset, the Court noted that neither the statute itself nor its legislative history defined the relevant term. Thus, the Court looked to previous construction of "investment contracts" by state courts prior to the adoption of the federal statute. The principal virtue of this construction, according to the Supreme Court, was that "[f]orm was disregarded for substance and emphasis was placed upon economic reality." Id. at 298 (emphasis added). Accordingly, the Court adopted the same interpretation to govern the application of the Securities Acts:

> In other words, an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal cer-

tificates or by nominal interests in the physical assets employed in the enterprise.

Id. at 299 (emphasis added). Stressing the reason for its adherence to a standard of "economic reality," the Court concluded:

> [i]t embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.

Id.

The Court's next major focus on the reach of federal securities law occurred in United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) in which, as will be seen, the Court continued to emphasize the fundamental necessity of examining the economic reality of the transaction. At issue in Forman was the applicability of the Securities Act of 1933 and the Securities Exchange Act of 1934 to the sale of shares of stock in a state subsidized nonprofit housing cooperative. This transaction posed a similar definitional (and, hence, jurisdictional) inquiry.

Of the two grounds on which the Court of Appeals relied in concluding that the Securities Acts were applicable, the first was the express language of the Acts themselves: it held that "... since the shares purchased were called 'stock' the Securities Acts, which explicitly include 'stock' in their definitional sections were literally applicable." Id. at 846. This rationale was expressly rejected by the Supreme Court. Instead, it "... adhere[d] to the basic principle that has guided all of the

[Supreme] Court's decisions in this area, "[id. at 848, emphasis added], viz, the economic reality test of Howey, supra. Id.; see also Tcherepnin v. Knight, 389 U.S. 332, 336 (1967). The Court explained:

> Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto.

Id. at 849.*

---

*As further support for its view that a contextual rather than a literal application of the Securities Acts was required, the Court in Forman referred to its earlier analysis of the term "security" in SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1946). While recalling statements in that opinion to the effect that "[i]nstruments may be included within [the definition of a security], as a matter of law, if on their face they answer to the name or description," and that a security "might be shown by proving the document itself, which on its face would be a note, a bond, or a share of stock," [Joiner, supra, 320 U.S. at 351, 355, cited by Forman at 421 U.S. 849-50, emphasis supplied by Forman], the Court also stressed that "[b]y using the conditional words 'may' and 'might'... the Court [in Joiner] made clear that it was not establishing an inflexible rule barring inquiry into the economic realities underlying a transaction." Forman, supra, 421 U.S. at 850. Thus, the Court's repeated references to Howey, supra, Tcherepnin, supra and Joiner, supra, explain its description of the "economic reality"

(Footnote continued on next page)...

The Court applied in this portion of its opinion the "economic reality" test for identifying "securities" transactions, consisting of the three part formula previously established by the Court in Howey with reference to an "investment contract." To qualify as a "securities" transaction, the transaction must involve (1) an investment of money, (2) in a common enterprise, with (3) an expectation of profits to come from the entrepreneurial or managerial efforts of others. 412 U.S. at 852.

The Court applied this three part test, concluding that the sale of the cooperative housing stock at issue was not the type of transaction Congress intended to regulate under the Securities Acts because "the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit" 421 U.S. at 851.

The Court of Appeals in Forman had held in alternative holding that the Securities Acts were applicable because the cooperative housing shares were "investment contracts." In the latter portion of its opinion, this Court in Forman rejected the Court of Appeals' alternative holding.

The Court began its analysis in the latter portion of its opinion by again applying the "economic reality" analysis, stating:

> In considering these claims [that the shares were "investment contracts"] we

---

...(Footnote continued from previous page)

test as "... the basic principle that has guided all of the [Supreme] Court's decisions in this area." Forman, supra at 848.

again must examine the substance -- the economic realities of the transaction -- rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an 'investment contract' and an 'instrument commonly known as a security.' In either case, the basic test for distinguishing the transaction from other commercial dealings is

> whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.

Forman, supra, 421 U.S. at 852 (emphasis added), citing Howey, supra, 328 U.S. at 301.

The Forman Court clearly acknowledged a unified standard for the evaluation of all "securities." In other words, the "economic reality" test, the "guiding principle" in this general inquiry, is applicable to all purported security transactions, regardless of the characterization of the instrument by which the transaction is effectuated. The fundamental element of that test is the expectation that profits will be derived from the efforts of others. As the Court summarized in Forman, "[w]hat distinguishes a security transaction -- and what is absent here -- is an investment where one parts with his money in the hope of receiving profits from the efforts of others..." Forman, supra, 421 U.S. at 858.

* * *

The Forman Court's discussion of the "investment contract" issue in the latter part of its Opinion has lead certain lower federal courts to interpret Forman as establishing a wholly bifurcated, "seriatim" test,

the two parts of which must be applied discretely depending on whether the instrument is labeled as "stock" or "investment contract." This approach is illustrated by decisions from the Second Circuit Court of Appeals in Golden v. Garafalo, 678 F.2d 1139 (2nd Cir. 1982) and Seagrave Corp. v. Vista Resources, Inc., 696 F.2d 227 (2d Cir. 1982). This approach proceeds on two basic assumptions: first, that Forman intended to promulgate a "two-part, seriatim" test, only the second part of which consists of the "economic reality" analysis and, second, that Forman in fact prohibited an examination of economic reality where the instruments at issue possess the "characteristics associated with ordinary, conventional shares of stock." The essential attribute of this method of analysis is the resort to the literalism of the statutory definition which was expressly repudiated by the Supreme Court. Golden, for example, frankly rejects the concept that economic reality is "... the universal jurisdictional test under the Acts." Golden v. Garafalo, supra, 678 F.2d at 1144. Similarly, the Court in Seagrave Corp. v. Vista Resources, Inc., supra, concluded, on the authority of Golden, that "[w]e must now regard ordinary 'stock' as 'securities' within the meaning of the '33 and '34 Acts regardless of the nature of the transaction in which the 'stock' is transferred." 696 F.2d at 229 (emphasis added). Accord, Daily v. Morgan, 701 F.2d 496 (5th Cir. 1983); Coffin v. Polishing Machines, Inc., 596 F.2d 1202 (4th Cir. 1979), cert. den'd, 444 U.S. 868 (1979). See also, Note, Repudiating the Sale of Business Doctrine, 83 Colum.L.Rev. 1718 (1983).

The refusal of the above-cited Courts to examine the nature of the underlying transaction is at odds with the economic reality test which the Supreme Court has consistently

employed in evaluating all purported security transactions and is inconsistent with post Forman Supreme Court authority.

In International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979), the Court considered whether a non-contributory, compulsory pension plan was an "investment contract." Rejecting the plaintiff's argument that the Federal Security laws applied, the Court stated:

> In Forman, supra, we observed that the Howey test, which has been used to determine the presence of an investment contract, 'embodies the essential attributes that run through all the Court's decision to finding a security' 421 U.S. at 852, 44 L.Ed. 2d 621, 95 S.Ct. 2051.

439 U.S. at 558 n.11.

In Marine Bank v. Weaver, 455 U.S. 551 (1983), the Court applied the "economic reality" analysis to the following fact situation. Plaintiffs had guaranteed a bank loan made to third parties and as collateral pledged a Certificate of Deposit. Plaintiffs received in return from the third party borrowers the right to receive 50% of the net profit of a business owned by the borrowers, the right to use facilities of the borrowers' business, and the right to veto future loans to the borrowers. The District Court dismissed the Complaint for lack of federal jurisdiction and the Third Circuit Court of Appeals reversed.

This Court considered two issues: first, whether the Certificate of Deposit was a "security," and second, whether the private agreement between the parties was a "security."

The Court initially held that the Certificate of Deposit was not a security, stating:

> The definition of "security" in the 1934 Act provides that an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires. It is unnecessary to subject issuers of bank certificates of deposit to liability under the anti-fraud provisions of the Federal Securities laws since the holders of bank certificates of deposit are abundantly protected under the Federal Banking laws. We therefore hold that the Certificate of Deposit purchased by the Weavers is not a security.

455 U.S. at 558-59.

The Court went on to hold that the agreement between the parties was not a security for two reasons: first, the transaction had a "unique character" because it was specifically negotiated between the parties to accommodate their needs, and second, that the plaintiffs' right to veto future borrowings gave them "a measure of control" over the operation of the business not characteristic of a security. 455 U.S. at 560.

The Weaver Court left no doubt that the "economic reality" test is to be applied uniformly, stating:

> Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole.

455 U.S. at 560 n.11.

Numerous lower federal courts have followed the Forman method of analysis. In

Fredericksen v. Poloway, 637 F.2d 1147 (7th Cir. 1981), cert. denied 451 U.S. 1017 (1981), for example, the Court considered the applicability of the Securities Acts to a transaction which was characterized by an agreement to purchase the assets of a business, a stock purchase and voting trust agreement and employment and management agreements between the purchaser and seller. The Court noted at the outset:

> This case involves the scope of the federal securities laws. The question we confront is whether alleged fraud regarding the sale of assets and stock in a corporation falls within the scope of those laws. Not all sales transactions which involve 'stock' are necessarily covered by the securities laws. Rather, the test for coverage in general is whether the purchaser is placing money in the hands of another who will control the funds and business decisions. If, however, the purchaser is assuming control of the critical decisions of the corporation, then the transaction is not considered to involve 'securities.'

Id. at 1148. Referring to the Forman Court's observation that securities transactions are economic in character [Forman, supra, 421 U.S. at 849], the Fredericksen court concluded that "the 'economic reality' of a transaction is always a key issue." Fredericksen, supra, 637 F.2d at 1152, n.2 (emphasis added).

This position has been consistently followed by the Seventh and other Circuits. In Canfield v. Rapp & Son, Inc., 654 F.2d 459 (7th Cir. 1981), the Court recalled the observation in Forman that the economic reality test "embodies the essential attributes that

run through all of [the Supreme] Court's decisions defining a security" [id. at 464, citing Forman, supra, 421 U.S. at 852], and concluded that the Supreme Court "... did not exempt any particular type of security from the test." Canfield, supra, 654 F.2d at 464. At the same time, while agreeing that the name and characteristics of a particular instrument are "... factors to consider in applying the economic reality test," [id. at 464-65], the Court nonetheless concluded that

> In order to determine whether these factors are dispositive, it still is necessary to look beyond the form of the instrument involved to the reality of the particular transaction.

Id.

The application of the economic reality test was further explored in Sutter v. Groen, 687 F.2d 197 (7th Cir. 1982). The Court therein addressed the distinction posited by the Second Circuit in Golden v. Garafalo, supra, between "unique or idiosyncratic instruments" and conventional or "garden-variety common stock." Golden, supra, 678 F.2d at 1144; Sutter, supra, 687 F.2d at 200. The Golden Court had concluded that the economic reality test could only be applied to the unique instrument.

In rejecting this position, the court in Sutter looked first to the Supreme Court's post-Forman decision in Weaver. As in Weaver, the Court in Sutter v. Groen was faced with an instrument -- common stock -- which was also specifically included in the statutory definition of "security." Nonetheless, the Sutter Court looked to Weaver for guidance and observed that "[t]he [Supreme] Court got around the seemingly uncompromising statutory language by treating

the word 'context' in the introductory clause of section 3(a)(10) as having reference to the economic as well as linquistic context." Sutter, supra, 687 F.2d at 200. As to that context, the Court also remarked that "[t]here is a clear difference in principle between an investor and an entrepreneur..." [id. at 201], and concluded that, in the case before it, the purchaser had "[t]he entrepreneurial intention -- to buy assets to manage, rather than to rent capital to those who want to manage..." Id. at 202. This, of course, is precisely the third prong of the economic reality test, viz, that the investor must be "... led to expect profits solely from the efforts of the promoter or a third party." Howey, supra, 328 U.S. at 299.

This approach, it is submitted, is manifestly more faithful to the consistent pronouncements of the Supreme Court on this issue. It is also the approach that has been followed by numerous federal courts. See, King v. Winkler, 673 F.2d 342 (11th Cir. 1982); Kaye v. Pawnee Construction Co., 680 F.2d 1360 (11th Cir. 1982); Christy v. Cambron, 710 F.2d 669 (10th Cir. 1983); Chandler v. Kew, Inc., 691 F.2d 443 (10th Cir. 1977); Goodman v. De Azoulay, 554 F. Supp. 1029 (E.D. Pa. 1983); Oakhill Cemetery, Inc. v. Tri-State Bank, 513 F. Supp. 885 (N.D. Ill. 1982); Anchor-Darling Industries, Inc. v. Suozzo, 510 F. Supp. 659 (E.D. Pa. 1981); Reprosystem, B.V. v. SCM Corporation, 522 F. Supp. 1257 (S.D.N.Y. 1981).

Applying the "economic reality" test to the facts of this case, it is clear that the transaction did not satisfy the test of Howey and Forman, because "the profits of the enterprise would not be derived "soley" or substantially from the efforts of others." (App. at 307a-12 to 14). This conclusion is

not seriously disputed by Respondent Ruefenacht.

The trial court was clearly correct in ruling that the transaction at issue herein fails the Howey/Forman test because as a result of Ruefenacht's control of and participation in the company, "the profits of the enterprise would not be derived 'solely' or substantially from the efforts of others." (App. at 307a-13 to 14) As set forth in the Statement of Facts, Ruefenacht had control by virtue of his status with the company and by virtue of his actual participation. Ruefenacht's powers and activities are equivalent to control over Continental's affairs so that plaintiff "was not a passive investor who relied on others to manage the business." (App. at 307a-20 to 21).

CONCLUSION

The judgment of the Court of Appeals, insofar as it reversed the dismissal of the Complaint against petitioner and respondent Christopher J. O'Halloran should be reversed.

Respectfully submitted,

TOMPKINS, McGUIRE & WACHENFELD
Attorneys for Defendant-Appellee,
Christopher J. O'Halloran
550 Broad Street
Newark, New Jersey 07102

By: ______________________
Robert J. Kelly